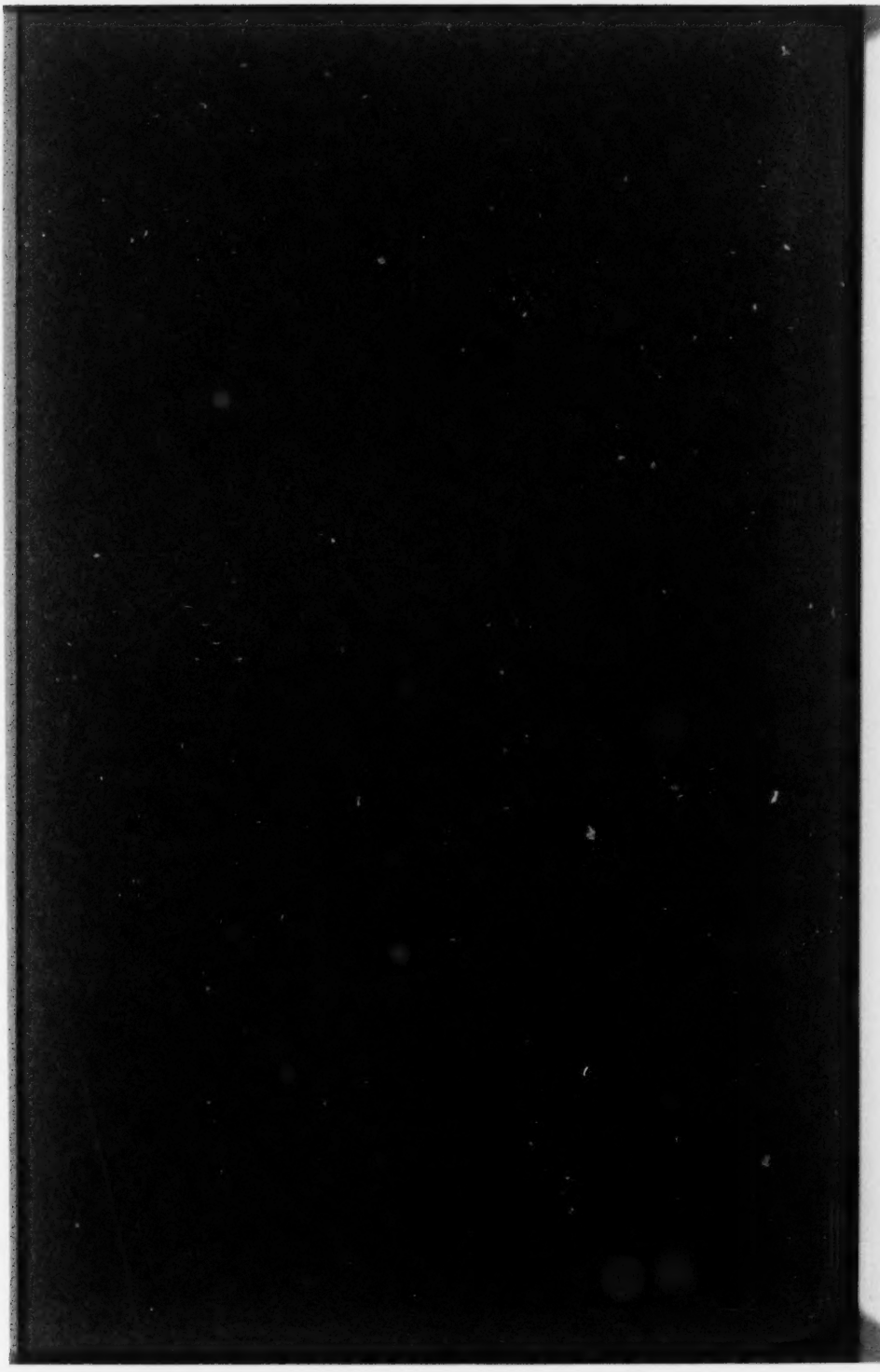

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 314

LAKESIDE IRRIGATION CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 28–34) is reported in 41 B. T. A. 892. There are also two unreported memoranda of the Board (R. 39–45, 49–55) which accompany two of its orders denying motions for rehearing. The opinion of the Circuit Court of Appeals (R. 65–68) is reported in 128 F. (2d) 418.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 20, 1942 (R. 68), and the petition

for a writ of certiorari was filed August 18, 1942. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer, a family corporation, transferred four blocks of securities at their market value to a stockholder, who owned directly or indirectly more than 50 percent of the taxpayer's capital stock, in partial satisfaction of a claim of the stockholder against the corporation. In two instances, the market value of the securities exceeded cost; in two it was less. There was a small overall net gain. The questions are:

1. Whether the transfers constituted "sales or exchanges" upon which no loss deductions would be allowable under Section 24 (a) (6) of the Revenue Act of 1936.

2. Whether gain or loss should be computed separately upon the transfer of each block of securities.

STATUTE AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 10–11.

STATEMENT

The facts found by the Board of Tax Appeals may be summarized as follows:

In April 1936 the Lakeside Irrigation Com-

pany owed more than $30,000 to Mrs. Louise Wintermann (R. 24) who held 332 of the 1,000 shares of the taxpayer's capital stock. Except for four qualifying shares, the remaining shares were owned by her children or grandchildren. (R. 28).

On April 16, 1936, O. J. Wintermann, the president of the taxpayer corporation, wrote Mrs. Wintermann, making the following alternative suggestions for the partial liquidation of her claim: (1) that the taxpayer corporation sell certain investment stocks owned by it and turn over the proceeds to her in partial satisfaction of the debt; or (2) that the investment stocks be turned over to her at their market value (R. 24). His letter further stated that "Of course, if we turn it over to you, if the Company ever got in dire need, you can let us use it as collateral security in case it is not to be sold" (R. 24–25).

Mrs. Wintermann accepted the second alternative on April 19, 1936. At a meeting of the board of directors the next day, the board was advised of the offer and acceptance and adopted a resolution, providing in part that the president (R. 25)—

> deliver these stocks to Louise Wintermann as soon as he has satisfied himself as to their market value, it being the intention of the Board that all these stocks be delivered at one time and as of the market value of a certain date, and that the Com-

pany credit the market value of these stocks as of the value date in a lump sum to the account of Louise Wintermann.

Thereafter the stocks were delivered to Mrs. Wintermann in consideration of the cancellation of indebtedness in the amount of $26,737.50, their market value on the date of the sale (R. 25).

These stocks consisted of four blocks which had been acquired at different times. The date of acquisition and cost and selling price of each of the four stocks sold, the gain or loss on each stock, and the net amount realized upon the sale are shown in the following table (R. 26):

Stock acquired	Cost	Selling price	Gain	Loss
1. 600 shares Reed Roller Bit, 10-10-29 and 11-15-30	$7,100.00	$13,500.00	$6,400.00	
2. 250 shares Dr. Pepper, 10-10-29	5,625.00	10,750.00	5,125.00	
3. 100 shares Columbia Gas, 9-18-29	11,750.50	1,725.00		$10,025.50
4. 100 shares N. American Aviation, 3-21-29	1,912.50	762.50		1,150.00
Totals	26,388.00	26,737.50	11,525.00	11,175.50

Aggregate selling price	$26,737.50
Aggregate cost of stocks	26,388.00
Net gain	349.50

The taxpayer in its income tax return for 1936 reported as income only the net gain upon the sale of this stock ($349.50), after setting off the loss sustained upon the Columbia Gas and North American Aviation shares against the gain realized upon the Reed Roller Bit and Dr. Pepper shares (R. 27).

The Commissioner determined that each block of stock represented a separate sale or exchange; that the losses arising from the separate sales or exchanges were not deductible under Section 24 (a) (6) of the Revenue Act of 1936; and that such losses could not be applied to reduce the gains from the sales or exchanges of other assets. The Board of Tax Appeals sustained the Commissioner (R. 28–34), and the court below affirmed (R. 65–68).

ARGUMENT

1. Section 24 (a) (6) of the Revenue Act of 1936 provides that in the computation of net income no deduction shall in any case be allowed in respect of loss from "sales or exchanges" of property, directly or indirectly, between an individual and a corporation in which the individual owns, directly or indirectly, more than 50 percent of the outstanding stock. The section further provides that an individual shall be considered as owning stock owned directly or indirectly by his family, and the term "family" is defined to include brothers, sisters, spouse, ancestors, and lineal descendants. It is not disputed that Mrs. Wintermann owned directly or indirectly more than 50 percent of the taxpayer's outstanding stock. Accordingly, any loss resulting from the transfer of the securities to Mrs. Wintermann was not deductible if the transfer was a sale or exchange within the meaning of the statute. On this point, the decision below was

clearly correct and in accord with settled authority; there is no occasion for further review by this Court.

The stock was transferred from the taxpayer to Mrs. Wintermann in return for a definite *quid pro quo*—that is, in partial satisfaction of her claim. Obviously, therefore, there was a sale or exchange within the normal meaning of these terms. In view of the plain language of the statute, there is no room for the interpretation, suggested by the taxpayer (Pet. 9), which would apply it only to *mala fide* sales or exchanges. Furthermore, it has been well established that where a debtor conveys property to a creditor in satisfaction of an obligation, the debtor has made a "sale" within the meaning of that term as used in the capital gain or loss provisions of the statute.[1] E. g., *Burger-Phillips Co.* v. *Commissioner,* 126 F. (2d) 934 (C. C. A. 5th); *Richter* v. *Commissioner,* 124 F. (2d) 412 (C. C. A. 2d); *Larus* v. *Commissioner,* 123 F. (2d) 254 (C. C. A. 2d); *Warren* v. *Commissioner,* 117 F. (2d) 82 (C. C. A. 6th); *Grandsden & Co.* v. *Commissioner,* 117 F. (2d) 80 (C. C. A. 6th); *Wieboldt* v. *Commissioner,* 113 F. (2d) 384 (C. C. A. 7th); *Pender* v.

[1] Section 117, Revenue Act of 1938, c. 289, 52 Stat. 447; Section 117, Revenue Act of 1936, c. 690, 49 Stat. 1648; Section 117, Revenue Act of 1934, c. 277, 48 Stat. 680; Section 111, Revenue Act of 1932, c. 209, 47 Stat. 169; Section 112, Revenue Act of 1928, c. 852, 45 Stat. 791; Section 208, Revenue Act of 1926, c. 27, 44 Stat. 9.

Commissioner, 110 F. (2d) 477 (C. C. A. 4th); certiorari denied, 310 U.S. 650; *Rogers* v. *Commissioner,* 103 F. (2d) 90 (C. C. A. 9th), certiorari denied, 308 U. S.580.[2] There is no valid basis for ascribing a narrower content to the same terms in Section 24(a) (6).

2. The second question involves the correct method of computing the taxpayer's net income upon the transaction in issue, after it is recognized that no loss will be deductible under Section 24 (a) (6). As we have stated, the court below affirmed the Board of TaxAppeals in holding that gain or loss should be computed separately upon each block of securities sold to Mrs. Wintermann, the losses being denied under Section 24 (a) (6) and the gains taxed. The taxpayer's contention, in substance, is that the separate identities of the four blocks of securities should be disregarded; consequently only the net over-all gain would be taxed, the losses on two of the individual blocks being used to offset the gains on the other two.

The issue arises from the application of Section 24 (a) (6) to the particular facts of the case. The Board of Tax Appeals has reached the same result in a similar situation in *M. F. Reddington, Inc.,* v. *Commissioner,* decided February 16, 1942

[2] Where the debtor is not released from liability on the debt by the transfer of property, it has been held that there is no sale or exchange because he has received nothing. *Polin* v. *Commissioner,* 114 F. (2d) 174 (C. C. A. 3d). Cf. *Commissioner* v. *Paulson,* 123 F. (2d) 255 (C. C. A. 8th).

(Prentice-Hall, B. T. A. Memorandum Decisions Service, Par. 42, 101), now pending on petition for review to the Circuit Court of Appeals for the Second Circuit. We submit that the position taken by both the court below and the Board is correct. In the absence of a conflict among the circuits, there is likewise no occasion for further review of this issue.

The gain and loss provisions of the statute (Sections 111, 112, 117, and 118 in the 1936 Revenue Act) contemplate that the gain or loss upon each piece of property sold or exchanged is to be computed by the difference between its cost base and the amount received therefor. Each piece of property is treated separately.[3] Thus, as the court below aptly stated (R. 67), "where, as here, four unrelated lots of stock were separately acquired and might readily have been separately sold, the fact that after ascertaining the value of each lot all were transferred together for a lump price will not require or authorize a merger of costs."

[3] An example is the "first in, first out" rule. The regulations have long provided that where stock has been purchased at various times for various prices and where the identity of shares subsequently sold cannot be determined, the stock sold shall be charged against the earliest purchase for purposes of determining gain or loss upon the sale. Treasury Regulations 94, Article 22(a)–8. See also Treasury Regulations 86, Article 22(a)–8; Treasury Regulations 77, Article 58; Treasury Regulations 74, Article 58; Treasury Regulations 69, Article 39; Treasury Regulations 65, Article 39; Treasury Regulations 62, Article 39; Treasury Regulations 45, Article 36.

The propriety of this approach in the instant case is emphasized by the comprehensive language of Section 24 (a) (6). The section does not provide for the disallowance merely of "net losses." On the contrary, it provides that in computing net income "no deduction shall in any case be allowed" in respect of the types of losses specified. If only the net gain on this over-all transaction were taxed, the taxpayer would be allowed by indirection the benefit of the losses which the statute has denied.

The numerous decisions of this Court and the Circuit Courts of Appeals cited by the taxpayer in support of its position involve the application of different sections of the statutes to dissimilar factual situations. They do not establish a conflict.

CONCLUSION

The decision below is correct on both issues, and there is no conflict. Accordingly, the petition for certiorari should be denied.

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SEPTEMBER 1942.